Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of the	)	
	)	
2000 Biennial Regulatory Review	)	CC Docket No. 00-175
Separate Affiliate Requirements of Section	)	
64.1903 of the Commission's Rules	)	

INITIAL COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

The National Telephone Cooperative Association (NTCA)[1] hereby submits its initial comments in the above-captioned proceeding. In this proceeding, the Federal Communications Commission (Commission or FCC) is considering alternative proposals for applying the separate affiliate requirement to a more limited category of independent incumbent local exchange carriers (ILECs) providing in-region, interexchange services. Most of NTCA's members are currently exempt from the Commission's separate affiliate requirement because they provide in-region, long distance services solely through resale using a separate division. NTCA therefore urges the Commission to maintain the exemption from the separate affiliate requirement for independent ILECs provisioning in-region, long distance resale service through a separate corporate division. NTCA also urges the Commission to exempt all rural telephone companies from the separate affiliate requirement.

[1] NTCA is a non-profit corporation established in 1954. The association represents 550 rural incumbent local exchange carriers. Its members are full service telecommunications companies providing local, wireless, cable, Internet, satellite and long distance services to their communities. Rural ILECs provide

I. THE FCC SHOULD MAINTAIN ITS EXEMPTION FROM THE SEPARATE AFFILIATE REQUIREMENT FOR ILECS PROVIDING RESALE LONG DISTANCE SERVICES

On August 14, 1997, NTCA petitioned the FCC for reconsideration of its requirement that independent ILECs provide in-region, interstate and international interexchange services only through a separate legal affiliate.[2] NTCA argued that rural ILECs had resold interexchange service through separate divisions since 1984 without any adverse impact on long distance service competition or the FCC's regulatory requirements. NTCA identified that in many instances rural ILEC resale operations are the primary, and often the only, source of long distance service competition in most rural ILEC service areas. Imposing the separate affiliate requirement on rural ILECs would therefore only cause them to incur additional legal, accounting, and administrative costs and fail to provide the Commission with any corresponding safeguards against anti-competitive behavior. In addition, the all-or-nothing separate affiliate requirement would have resulted in the inadvertent and adverse consequence of limiting the tax status options available to rural telephone cooperatives under the Internal Revenue Code and increase their cost of providing both local and toll services.[3] NTCA therefore

telecommunications services to approximately 40 percent of the geographic area of the United States and are dedicated to ensuring the economic future of rural America.

[2] NTCA's Petition for Reconsideration of the *Second Report and Order in CC Docket No. 96-149, and Third Report and Order in CC Docket No. 96-61,* FCC 97-142, (rel. April 18, 1997).

[3] Telephone cooperatives may qualify for tax-exempt status under the Internal Revenue Code if no less than 85 percent of their revenues consist of amounts collected from members for the sole purpose of meeting losses and expenses. 26 U.S.C. § 501(c)(12)(A). An Internal Revenue Service (IRS) Technical Advice Memorandum (TAM) issued in 1997 held that the gross income from the subsidiary of a telephone cooperative is to be counted as non-member income in applying the 85 percent test. Priv. Let. Rul. 97-22-006 (Feb. 7, 1997). Thus, the FCC's previous requirement that all independent ILECs provide interexchange service through a separate affiliate could eliminate the tax exemption option for telephone cooperatives selling interexchange services, thereby increasing their cost of providing services. *NTCA Petition for Reconsideration,* p. 10.

recommended that the Commission permit rural ILECs to continue to provide in-region, long distance services through a separate division that is not a separate legal entity.[4]

On May 18, 1999, the FCC agreed. The Commission granted NTCA's petition for reconsideration and established an exemption from the separate affiliate requirement for independent ILECs providing in-region, long distance service exclusively through resale using a separate corporate division, rather than a separate affiliate. The Commission found that rural ILEC resellers have virtually no incentive to provide poorer quality interconnection or impose unnecessary delays when connecting the underlying interexchange carrier to the independent LEC's network "because such discrimination would harm the ability of both the underlying interexchange carrier and the LEC to provide interstate long distance services."[5] The FCC further stated that the independent rural ILEC resellers are less likely to attempt to allocate cost improperly than other LECs providing facilities-based long distance services because "the wholesale rates of resold long distance services are more readily visible to auditors that the underlying transmission costs of a facilities-based carrier, for which the Commission and carriers do not have precise information."[6] In many rural areas the FCC found that the rural ILEC is the "sole provider of interexchange service, typically through resale, in competition with the large interexchange carriers."[7] The Commission also determined the separate legal entity requirement would have required a significant number of rural ILECs to

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[4] *Id.*

[5] *In the Matter of the Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* CC Docket No. 96-149; *and Policy and Rules Concerning the Intrastate, Interexchange Marketplace,* CC Docket No. 96-61; *Leaco Rural Telephone Cooperative, Inc., Petition for Waiver,* 96-149 and 96-61, ¶ 22 (rel. June 30, 1999).

[6] *Id.,* ¶ 22.

[7] *Id.,* ¶ 23.

substantially alter their long distance operations resulting in significant cost increases.[8] Lastly, the Commission acknowledged that the separate legal entity requirement would have resulted in the unintended consequence of removing the tax-exempt status of many rural ILEC cooperatives.[9]

The conditions and circumstances that affected independent rural ILECs and influenced the Commission in 1999 still exist today. Rural ILECs continue, in many areas, to be the only entities willing to offer competitive toll services in rural areas or are one of a small number of such entities competing in other rural areas. Most independent rural ILECs are small businesses and lack the resources necessary to construct and operate their own interstate or international networks. They continue to resell the services of facilities-based interexchange carriers and lack the resources needed to market their resold services beyond their exchanges and adjacent areas. The small scope of their operations and their dependence on facilities-based interexchange carriers make it most unlikely that rural ILECs can develop sufficient market power to control long distance prices, engage in anti-competitive behavior, or discourage other potential competitors from entering the market. Indeed, there is no evidence whatsoever that the provision of interexchange services by existing divisions of independent rural ILECs has resulted in cost-shifting or otherwise adversely affected interexchange competition or rates. The small size of rural ILECs – averaging less than 25 employees per company – would continue to exacerbate the costs and dislocations inherent in the separate legal entity requirement, if the requirement were imposed on them. Furthermore, the additional

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[8] *Id.,* ¶ 21.

[9] *Id.,* ¶ 28.

regulatory burdens and potential adverse effect of the separate legal affiliate requirement on a telephone cooperative's tax-exempt status still exists today.

The Commission should therefore maintain its exemption for the separate affiliate requirement for independent ILECs reselling interexchange services through separate divisions. The separate division exemption has provided the Commission with its desired safeguards against cost misallocation, access discrimination and price squeezes. These benefits have clearly outweighed the additional costs associated with forming a separate legal entity and the loss of tax-exempt status that many telephone cooperatives would realize if the requirement were imposed on them. The safeguards associated with the separate division requirement have achieved the desired result.

II. NTCA ENCOURAGES THE COMMISSION TO EXEMPT ALL RURAL TELEPHONE COMPANIES FROM THE SEPARATE AFFILIATE REQUIREMENT

The Commission continues to require independent ILECs that are facilities-based providers of interstate, interexchange services to comply with the separate legal entity requirement. As a result, rural ILECs incur the additional expense associated with the rule regardless of their business need to operate facilities-based long distances services through a separate subsidiary. The Commission should take the further step of eliminating the separate affiliate rule for all rural telephone companies. Separate divisions for resellers has provided the needed safeguards against potential anti-competitive conduct in the case of resellers. They should be as effective for small facilities-based, long distance service carriers. Carriers operating with separate divisions are still required to maintain separate books of account and to comply with affiliated transaction rules. These are adequate safeguards. There is no reason to go beyond these and continue to impose section 272 separate affiliate requirements on non-Bell Operating Companies that were never intended to be covered by the statute. In some cases, the rule may result in lost tax-exempt status under 26 U.S.C. § 510(c)(12)(A).

III. CONCLUSION

Based on the reasons above, NTCA urges the Commission to maintain the exemption from the separate affiliate requirement for independent ILECs provisioning in-region, long distance resale service through a separate corporate division. NTCA also encourages the Commission to exempt all rural telephone companies from the separate affiliate requirement. In any event, rural cooperative telephone companies should be allowed to provision facilities-based long distance services through corporate divisions.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Gail C. Malloy, certify that a copy of the foregoing Comments of the National Telephone Cooperative Association in CC Docket No. 00-175, FCC 01-261 was served on this 1st day of November 2001 by first-class, U.S. Mail, postage prepaid, to the following persons

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